

The Honorable Thomas S. Zilly

UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF WASHINGTON AT SEATTLE

ST. PAUL FIRE AND MARINE
INSURANCE COMPANY, a Minnesota
corporation, and ST. PAUL GUARDIAN
INSURANCE COMPANY, a Minnesota
corporation,

Plaintiffs,

v.

HEBERT CONSTRUCTION, INC., a
corporation; MEADOW VALLEY, LLC, a
Washington limited liability company;
ROGER and SHELLY HEBERT,
individually and the marital community
thereof; HENRY and KAREN HEBERT,
individually and the marital community
thereof; ANDRZEJ and ROMA LAWSKI,
individually and marital community thereof;
JAMES and ANNE KOSSERT, individually
and the marital community thereof; and
ADMIRAL INSURANCE COMPANY, a
Delaware corporation

Defendants.

NO. C05-0388TJZ

**MEADOW VALLEY
DEFENDANTS' TRIAL BRIEF**

The Meadow Valley Defendants respectfully submit this trial brief to the court
addressing the issues to be determined at the time of trial.

MEADOW VALLEY DEFENDANTS'
TRIAL BRIEF - 1

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10383-026964 109181

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I. AUTHORITY

A. AGENCY¹

1. Marsh was St. Paul's agent for the insurance transactions in this case.

The Washington Insurance Code contains several provisions defining agents, brokers, and their respective relationships with insurance companies and insureds. RCW 48.17.010 defines "agent" as "any person **appointed by an insurer** to solicit applications for insurance on its behalf." (Emphasis added). RCW 48.17.020 defines "broker" as:

. . . any person who, on behalf of the insured, for compensation as an independent contractor, for commission, or fee, **and not being an agent of the insurer**, solicits, negotiates, or procures insurance or reinsurance or the renewal or continuance thereof, or in any manner aids therein, for insureds or prospective insureds other than himself.

(Emphasis added). Both agents and brokers must be licensed in order to transact business. RCW 48.17.060. "Each insurer on appointing an agent in [Washington] shall file written notice thereof with the commissioner on forms as prescribed and furnished by the commissioner. . . ." RCW 48.17.160(1).

Generally, an insurance agent represents the insurer, while an insurance broker represents an insured. AAS-DMP Mgmt., L.P. Liquidating Trust v. Acordia N.W., Inc., 115 Wn. App. 833, 838, 63 P.3d 860 (2003) (*citing* RCW 48.17.010, defining "agent," and RCW 48.17.020, defining "broker"). "A broker, **as such**, is not an agent or other representative of an insurer, and does not have power, by his own acts, to bind the

¹ This section repeats in slightly greater detail the same agency analysis set forth in the Meadow Valley Defendants' motion filed 9/14/06 (*Docket #155*) for reconsideration / clarification of the court's 9/7/06 order granting summary judgment (*Docket No. 141*). Even if the court does not grant reconsideration, and/or does not remove this issue from the jury's consideration at the close of evidence, the discussion herein informs how the jury should be instructed on this issue.

insurer upon any risk or with reference to any insurance contract.” RCW 48.17.260(1). However, in this case, Marsh was *not* a broker according to the Insurance Code because the statutory definition of “broker” requires that a broker “not be an agent of the insurer.” RCW 48.17.020. Because Marsh was an appointed St. Paul agent, it does not qualify as a broker in this case.

Another Insurance Code provision clearly confirms Marsh can be a broker as to some relationships or transactions and an agent as to others, but cannot be a broker as to a transaction it is appointed as an agent:

A licensed agent may be licensed as a broker and **be a broker as to insurers for which the licensee is not then appointed as agent.** A licensed broker may be licensed as and be an agent as to insurers appointing such agent. The **sole relationship** between a broker and an insurer as to which the licensee is **appointed as an agent shall**, as to transactions arising during the existence of such agency appointment, **be that of insurer and agent.**

RCW 48.17.270(1) (emphasis added). Thus, in Washington, when an insurer appoints a licensed broker/agent as its agent, as St. Paul did when it appointed Marsh as its agent, that broker/agent becomes the insurer’s agent **as to all transactions** arising during the appointment. Factually, Marsh was unquestionably acting as the broker for the Meadow Valley Defendants when it shopped for insurance on its behalf, but when the product it considered or selected involved St. Paul (or any other insurer for whom it was an appointed agent), Marsh’s status changed to that of agent of the insurer.

No Washington state court has interpreted RCW 48.17.270, and although one federal case interpreted the state statute, that case dealt with a different issue and is not

controlling.² However, in In Re Tutu Water Wells Contamination Litigation, 78 F. Supp. 2d 436, 448 (D.V.I. 1999), the court interpreted a statute of the Virgin Islands almost identical to RCW 48.17.270.

A licensed agent may be licensed as a broker and be a broker as to insurers for which he is not then licensed as agent. A licensed broker may be licensed as and be an agent as to insurers appointing him as agent. The sole relationship between a broker and an insurer as to which he is licensed as an agent shall, as to transactions arising during the existence of such agency appointment, be that of insurer and agent.

V.I. Code Ann. Tit. 22 § 766. The Tutu Water Wells court rejected an insurer's argument that the broker was a dual agent, and held, pursuant to this statute, that a broker/agent was an agent of the insurer for transactions during the course of the agency appointment:

Cigna's first argument, **that the existence of a dual agency relationship created a question of fact for the jury, does not appear supported by Virgin Islands law.** The Virgin Island Code provides, in pertinent part, that a "broker may be licensed as . . . an agent as to insurers appointing him as agent. The **sole relationship** between a broker and an insurer as to which he is licensed as an agent **shall, as to transactions arising during the existence of such agency appointment, be that of insurer and agent.** See V.I. Code Ann. Tit 22 § 766 (1993) (emphasis added). **...[T]he statute's mandate appears clear: an insurer is bound by all acts performed by its agent during the course of the agency relationship....**

Cigna, however, contests the statute's applicability in the instant matter, arguing that since the statute "does not define the relationship between brokers and insureds, it does not preclude a finding of dual agency." (See Cigna Br. At 7). **This argument misses the point: regardless of whether West Indies [the agent] was also acting on [the insured's] behalf with respect to the notice of claims, VI law has clearly established that, assuming the notification occurred during the agency relationship, West Indies was acting on behalf of the [insurers] as a matter of law.**

² The court is aware of Northwestern Nat'l Ins. Co. v. Federal Intermediate Credit Bank of Spokane, 839 F.2d 1366 (9th Cir. 1988), which discusses RCW 48.17.270 in the context of a broker who was appointed as an agent for lines of insurance (property and casualty) different from the line of insurance at issue in the lawsuit (marine), and stands for the proposition that the agency relationship is limited to the type of coverage the insurer has authorized in the appointment. This court has already held that the case is of no assistance in this case. *9/7/06 Order on summary judgment motions, p. 16, fn. 7 (Docket No. 141).*

1 Id. (emphasis added). Likewise, under Washington's nearly identically-worded statute,
 2 because St. Paul appointed Marsh as its agent for property and casualty insurance, and
 3 because the insurance at issue in this case is casualty insurance, the sole relationship
 4 between St. Paul and Marsh during the existence of that agency appointment is that of
 5 insurer and agent. Thus, Marsh was St. Paul's agent as a matter of law.

6 Prosser Com'n Co., Inc. v. Guar. Nat'l Ins. Co., 41 Wn. App. 425, 700 P.2d
 7 1188 (1985) did not involve the application of RCW 48.17.270. In that case, the court
 8 summarized the relationship of the parties as:

9 . . . the Commission brought this action against Guaranty alleging Guaranty
 10 violated its duty to defend or pay the Whitby judgment. It also sued Francis
 11 Moore, its insurance broker, for failing to obtain adequate insurance
 protection.

12 Id. at 428. The court then set forth its analysis of coverage, which contains no mention
 13 of conduct by the broker or other extrinsic evidence. The court held that the liability of
 14 the Commission was covered under the policy, and reversed the trial court's dismissal of
 15 the claims against Guaranty. The opinion concludes with the following observations
 16 regarding the claim asserted against Mr. Moore.

17 At to Mr. Moore, the Commission contends the court erred in determining
 18 he was neither an apparent agent for Guaranty nor liable for failure to
 19 procure coverage for this incident. While our determination of coverage
 20 disposes of the contention that Mr. Moore did not obtain coverage and
 21 supports the trial court's dismissal of the cause of action against Mr.
 22 Moore, the decision was also correct based on the finding no agency
 23 existed between Guaranty and Mr. Moore. Generally, an insurance broker
 is the agent of the insured. Whether the broker is also the agent of the
 insurer is a question of fact and depends upon what he is doing and for
 whom when the liability arises. Additionally, there must be some evidence
 or fact from which a fair inference of authorization by the insurer may be
 deduced in order to make the broker the agent of the insurance company.
 Here, the record supports the conclusion Mr. Moor was not authorized to
 act as Guaranty's agent. [Internal citations omitted.]

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1 Id. at 433. In Prosser, there was no issue that Mr. Moore was the agent of the insured;
 2 the only issue was whether he was also the agent of the insurer. Moreover, it appears
 3 that the Commission raised the apparent agent issue in an effort to make the insurer
 4 vicariously liable for his alleged negligence in failing to procure the proper coverage.
 5 Since the court determined that coverage existed, which also precluded a determination
 6 of negligence, the court's comments regarding agency are mere dicta.

7 **2. If RCW 48.17.270 is not determinative of Marsh's status, the common**
 8 **law also dictates that Marsh is St. Paul's agent.**

9 Even if the court finds that the "sole relationship" statute does not conclusively
 10 determine Marsh's status as St. Paul's agent, the common law dictates that Marsh is St.
 11 Paul's agent. An independent insurance agent may be the agent of an insurer, even
 12 though the agent is licensed to sell insurance products for a variety of insurers, where
 13 the insurer has an agency appointment on file with the state Department of Insurance
 14 listing the agent as the insurer's agent, and the insurer has a written agency appointment
 15 agreement expressly authorizing the agent to transact business on behalf of the insurer
 16 as its agent. E.g. Loehr v. Great Republic Ins Co., 226 Cal. App. 3d 727, 732-33, 276
 17 Cal. Rptr. 667 (1991) (holding that the trial court committed error in not instructing the
 18 jury that an independent insurance agent was an agent of the insurer).

19 Thus, if insurance is written in companies which the agent does not represent, he
 20 or she is generally regarded as acting as a broker and as the agent of the insured in
 21 procuring insurance, whereas if the insurance is written in a company which he or she
 22 has been appointed as an agent, he or she is held to be the agent of the insurance
 23 company and not of the insured. E.g. Solomon v. Federal Ins. Co., 176 Cal. 133, 138,

1 167 P. 859 (1917) ("It is well settled that, where, in circumstances such as are presented
 2 here, an insurance agent requests insurance from a company which he does not
 3 represent, he is acting for the insured, who is responsible for misrepresentations in the
 4 application made out by the broker."); Norwalk Tire & Rubber Co. v. Manufacturers' Cas.
 5 Ins. Co., 109 Conn. 609, 145 A.44, 46 (1929) (agent, writing insurance in a carrier that it
 6 represented, held acting as carrier's agent under agency agreement and not as broker
 7 on behalf of insured); Ross v. Thomas, 45 Ill. App. 3d 705, 709, 360 N.E.2d 126 (1977)
 8 (broker who had no fixed or permanent relationship with an insurance company is not an
 9 agent of that insurance company when procuring insurance for his or her client);
 10 Lindstrom v. Employers' Indem. Corp., 146 Wash. 484, 487, 263 P. 953 (1928)
 11 (insurance agency, where not an accredited legal agent of insurer, was deemed agent of
 12 insured). The fact that an insurer has regularly appointed agents does not preclude the
 13 finding that a broker not regularly appointed is the agent of the insurer in a particular
 14 transaction. McCabe v. Hartford Acc. & Indem. Co., 90 N.H. 80, 4 A.2d 661, 664 (1939)
 15 ("It is of course entirely possible for the insurer, e.g., the insurance company, though
 16 having regularly appointed agents to also employ brokers upon particular occasions and
 17 in that event the broker will be primarily the agent of the insurer.").

18 **3. Even if Marsh is determined to be MVLLC's agent, Marsh's knowledge**
 19 **cannot be imputed to MVLLC to determine MVLLC's intention**
regarding the terms of the Association Policy.

20 Under Washington law, the goal of contractual interpretation is to determine and
 21 effectuate the parties' mutual intent. E.g. Santos v. Dean, 96 Wn. App. 849, 854, 982
 22 P.2d 632 (1999). Washington courts follow the objective theory of contracts, which
 23 requires "that we impute to a person an intention corresponding to the reasonable

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1 meaning of **his** words and acts. Petitioner's unexpressed impressions are meaningless
 2 when attempting to ascertain the mutual intentions of the parties.” Id. (emphasis added).
 3 “[M]utual intent may be established directly or by inference – but any inference must be
 4 based exclusively on the parties' objective manifestations.” Id.

5 Even if the court allows the “dual agency” question to go to the jury and the jury
 6 finds that Marsh was MVLLC’s agent, Edith Jacks’ knowledge cannot be imputed to
 7 MVLLC for the purpose of ascertaining MVLLC’s intention of what was to be covered by
 8 the insurance policy negotiated by Ms. Jacks. Flinn Realty Corp. v. Charter Const. Co.,
 9 169 N.Y.S. 116, 181 App. Div. 610 (1918). The court may rely only on MVLLC’s own
 10 objective manifestations. Santos, 96 Wn. App. at 854. In Flinn Realty, the plaintiff sued
 11 for rescission of a contract for the exchange of properties on the ground of mistake.
 12 Flinn Realty, 169 N.Y.S. at 117-18. The defendant argued that the plaintiff had
 13 knowledge of the actual facts because his agent, a broker, had such knowledge. Id. The
 14 court rejected this contention: “As to the fact of constructive notice by reason of his
 15 agency, this fact is without significance, because here is a question of actual intention,
 16 and actual intention can only be judged by actual knowledge and not by constructive
 17 knowledge.” Id.

18 Under statute and common law, Marsh is not the agent of MVLLC. Even if Marsh
 19 could be characterized as a dual agent, the knowledge of Edith Jacks may not be
 20 imputed to MVLLC for purposes of determining MVLLC’s intent. In the absence of any
 21 competent evidence demonstrating that MVLLC intended that the St. Paul Fire policy
 22 exclude construction activities, St. Paul cannot prove that MVLLC shared its restrictive
 23 intent. As such, the admissible extrinsic evidence St. Paul has submitted in this case

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1 fails to resolve the ambiguity found by the court in its September 7, 2006 Order. *Docket.*
 2 *No. 141, p. 14.* Hence, under well-settled Washington law, the ambiguities found by the
 3 court must be construed in MVLLC's favor and mandate a finding of coverage under the
 4 St. Paul fire policy. *Id.*

5 **B. COVERAGE UNDER THE ST. PAUL FIRE UMBRELLA POLICY**

6 The St. Paul Fire policy is actually a "package" policy consisting of several
 7 separate policies, providing property protection, commercial general liability, auto liability,
 8 and umbrella liability. *Trial Ex. 9, at SPT 00722.* The court has determined that the
 9 policy is ambiguous based on the "few, scattered references to a 'community
 10 association' and 'association activities,'" in the policy, which suggested to the court that
 11 the policy may have been limited to homeowner association settings. *Docket #141 at*
 12 *14:5-10.* However, the references that the court held created an ambiguity are all found
 13 in the 22 numbered page section of the package policy described as "community
 14 association package commercial general liability protection." *Trial Ex. 9 at SPT 00780-*
 15 *00801(hereafter "the primary policy").* The court also noted certain descriptions of
 16 parties under the heading "who is protected under this agreement" that might suggest an
 17 ambiguity, including "Association," "Unit Owners," and "Developer." *T9/7/06 Order*
 18 *(Docket # 141); Trial Ex. 9 at SPT 00784.*

19 The umbrella coverage portion of the package policy has the same basic policy
 20 structure as the primary policy. *Trial Exhibit 9 at SPT 00805-00832 (hereafter "the*
 21 *umbrella policy").* However, the terms "community association" and "association
 22 activities" are noticeably absent. Also, under the heading "who is protected under this
 23 agreement," there is no description of "Association," "Unit Owners," or "Developer." *Trial*

1 *Ex. 9 at SPT 00815.* Whereas the primary policy begins with the preamble “This liability
 2 insuring agreement provides general liability protection for your association activities,”
 3 *Trial Exhibit 9 at SPT 00780*, the equivalent preamble to the umbrella policy states “This
 4 insuring agreement provides excess liability protection for your business.”

5 The very words contained in the primary policy that caused the court to conclude
 6 the primary policy is ambiguous are missing from the umbrella policy. It necessarily
 7 follows that if there is no ambiguity, the court is not entitled to consider extrinsic
 8 evidence, and must conclude from the four corners of the umbrella policy that it provides
 9 coverage for the liability of MVLLC represented by the covenant judgment settlement
 10 entered in the underlying action. Therefore, even if the jury finds Marsh to be the agent
 11 of the Meadow Valley Defendants, and that finding causes the court to conclude there is
 12 no coverage under the primary policy portion of the St. Paul Fire package policy,³ the
 13 jury should still decide the issues related to the Meadow Valley Defendants’ claim for
 14 breach of contract as to the umbrella policy portion of the St. Paul Fire package policy.

15 **C. BURDEN OF PROOF ON BREACH OF CONTRACT CLAIMS**

16 Determining whether there is coverage is a two-step process. McDonald v. State
 17 Farm, 119 Wn.2d 724, 731, 837 P.2d 1000 (1992). First, the insured must prove that the
 18 loss falls within the policy’s insuring agreement. Id. Then, the burden shifts to the
 19 insurance company to prove that a limitation or exclusion applies. Id.

22 ³ At the final pre-trial conference, the court indicated its final determination of coverage under the St. Paul
 23 Fire policy would be coextensive with the jury’s finding on agency – in other words, whichever party wins
 the agency argument also wins the coverage argument as to that policy.

1 **1. What the Meadow Valley Defendants need to prove.**

2 To make their *prima facie* case under either St. Paul policy (both policies contain
3 identical insuring clauses), the Meadow Valley Defendants must simply show (a) the
4 Meadow Valley Defendants are legally required to pay as damages, (b) property damage
5 sustained by the Association, (c) that happened while the policy in question was in
6 effect, (d) and which is caused by an event (an event includes continuous or repeated
7 exposure to substantially the same harmful conditions). E-Z Loader Boat Trailers v.
8 Travelers Indem. Co., 106 Wn.2d 901, 906, 726 P.2d 439 (1986).⁴

9 ***a. Legal liability***

10 PUD No. 1 of Kittitas County v. International Ins. Co., 124 Wn.2d 789, 808 P.2d
11 1020 (1994) discusses several elements of the insured's burden of proof. In that case,
12 the court approved the following jury instruction:

13 Plaintiffs have the burden of proving, by a preponderance of the evidence,
14 all of the facts necessary to establish their claim for coverage under each
15 of its insurance policies. To meet this burden with respect to policies in
16 effect during a policy period Plaintiffs must prove that they satisfied the
terms and conditions of coverage ***and establish the existence of an
occurrence or occurrences resulting in loss during the policy period.***
[Emphasis by the court.]

17 Id. at 808. The defendants objected that this instruction was inadequate because it did
18 not require the insureds to prove they were actually liable to the underlying claimants in
19 the context of a settlement prior to trial. The court rejected the insurers' argument.

20 The plaintiffs claim, however, that because this is a case to enforce a
21 settlement, they need only prove that the allegation in the [underlying]
claims would have been covered by the policies.

22 ⁴ In its opposition to the Meadow Valley Defendants' summary judgment motion, St. Paul, citing E-Z
23 Loader, articulates the same description of the Meadow Valley Defendants' burden of proof, except it
combines elements (a) and (b). (*Docket No. 108, p. 19*).

* * *

We agree and hold that the Plaintiffs, in this action to collect insurance proceeds under the settlement agreement, need only prove the underlying claims were covered under the policies To require claims to be actually proved in an action to enforce a settlement and collect insurance proceeds would defeat the purpose of the settlement agreements. The [underlying] settlement was reached in part to avoid lengthy and difficult litigation of these very issues.

Id. at 809-810.

b. Property damage sustained by the Association.

In PUD No.1, not only were the insureds not required to prove actual liability; they were also not obliged to prove that 100% of the settlement amount was covered under the policies.

We also reject the Defendants' argument that the trial court erred when it failed to instruct the jury that it must allocate the settlement between covered and non-covered claims. . . . [T]he claims based on intentional acts of the individuals (which are not covered) and the claims based on negligence (which are covered) consist of the same factual core and, thus, require no allocation by the jury. Likewise, the damages arising from both the non-covered claims and the covered claims are the same and cannot be separated or allocated. The trial court correctly kept this issue from the jury. [Citations omitted.]

Id. at 810. In this case, the primary distinction between covered and non-covered claims or damages is between liability for "property damage" (covered) and "construction defects" (non-covered). The same rationale applies. If there is no basis to allocate the settlement amount between the two, then the entire settlement amount is covered. It necessarily follows that if there is a basis to allocate; St. Paul bears the burden of proof on the issue (discussed below).

1 **c. While the policy was in effect.**

2 St. Paul does not seriously dispute that damage occurred during the three year
3 term of the St. Paul Fire policy, April 15, 2000 through April 15, 2003. Conversely, the
4 term of the St. Paul Guardian policy is January 4, 1999 through February 4, 2000.
5 Because not all buildings had been completed by the time the policy expired, there may
6 be a limitation on the amount of coverage available for “completed work.”⁵ However, this
7 does not mean that the Meadow Valley Defendants are required to prove that damage
8 occurred between the time a particular building was completed and the time the policy
9 expired. The “completed work” coverage is contained within the “your work” exclusion.
10 The insuring language itself does not require the damage to occur after work is
11 completed, nor does the basis for the Meadow Valley Defendants’ liability to the
12 Association distinguish between damages that began to occur before any building was
13 completed or after any policy expired.

14 Even a “minute” amount of “property damage” occurring during the policy period
15 will suffice to trigger the St. Paul Guardian policy:

16 [W]hen courts are dealing with property damage situations where damages
17 slowly accumulate, courts have generally applied the exposure theory. **So**
18 **long as there is tangible damage, even if minute**, courts have allowed
coverage from that time. (Quoting from Ins. Co. of North America v Forty-
Eight Insulations, 633 F.2d 1212 (6th Cir. 1980). [Emphasis by the court.]

19 Villella v. Public Employees Mut. Ins. Co., 106 Wn.2d 806, at 814, 725 P.2d 957 (1986).

20
21 ⁵ In its proposed jury instructions, St. Paul would have the court inform the jury that the number of
22 completed buildings is four. The Meadow Valley Defendants will present evidence that the correct number
23 is nine (counting the recreation building). At this point, it is unclear whether the court intends to let the jury
decide this issue or will itself hear the evidence and decide the issue based on a legal interpretation of the
policy definition of “completed work” based on whether each building constitutes a separate “work site,”
and/or based on the requirement for a particular building to be “put to its intended use.”

1 ***d. Caused by an “event” – progressive damage caused by***
 2 ***continuous or repeated exposure to substantially the same***
 harmful conditions.

3 Much of the damage at issue in the underlying action involves decay of building
 4 components caused by unintended moisture intrusion. The parties disagree as to the
 5 extent of decay and when it becomes “property damage,” but there does not seem to be
 6 serious dispute that the cause of decay qualifies as an “event” under either St. Paul
 7 policy.

8 The question then becomes which insurer covered the damage – the
 9 insurer at the time of the defective backfilling, at the time of the discovery of
 10 the dry rot, or all insurers providing coverage during the total time period of
 11 the undiscovered condition which progressively worsened. The answer is
 determined by a consideration of whether the term “accident” or
 “occurrence” as used in the policy must of necessity be a single isolated
 event or whether it can be a continuing condition or process. The question
 is not a novel one:

12 “The accident mentioned in the policy need not be a blow but may be a
 13 process. It is not required that the injury be the result of some contact with
 14 the bulldozer or the shelf or a rock hurled over from the shelf. It is not
 required to be sudden like an Alpine avalanche. . . A glacier moves slowly
 but inevitably.”

15 Gruol Construction Co. v. Ins. Co. of North America, 11 Wn. App. 632, 635-36, 524 P.2d
 16 427 (1974). quoting Travelers v. Humming Bird Coal Co., 371 S.W.2d 35, 38 (Ky. App.
 17 1963).

18 **2. What St. Paul needs to prove.**

19 If the insured proves that the loss falls within the policy’s insuring agreement, the
 20 burden shifts to the insurance company to prove that a limitation or exclusion applies.

21 McDonald v. State Farm, 119 Wn.2d at 731.
 22
 23

1 **a. Policy exclusions**

2 In the present case, the only exclusion St. Paul has identified is applicable only to
3 the St. Paul Guardian policy, is the “your work” exclusion and the exception to that
4 exclusion where the work constitutes “completed work,” and “the damaged completed
5 work, or the completed work that causes the property damage, was done for you by
6 others.”⁶ St. Paul’s burden of proof therefore requires it to establish what portion of the
7 total property damage represented by the \$4,800,000 settlement is either (a) damage to
8 work that was not “completed” within the definition of the policy, or (b) damage to work
9 that was performed directly by HCI and not “done for you by others,” *i.e.* by a
10 subcontractor on HCI’s behalf.

11 **b. Limitations on coverage – allocation between covered and non-**
12 **covered claims or damages.**

13 Before St. Paul can prove any allocation of the \$4,800,000 settlement between
14 “property damage” and “construction defects” or other non-covered amounts, St. Paul
15 must first establish that there is a basis for allocation. Where the covered and non-
16 covered claims arise out of the same core facts, there is no basis for allocation. PUD
17 No. 1 of Kittitas County, 124 Wn.2d at 810. If St. Paul proves a basis to allocate, St.
18 Paul also bears the burden of proof on the amount of non-covered damage.

19 The trial court’s finding that Prudential made no attempt to segregate the
20 settlement in the instant case is amply supported. Prudential’s own witness,
21 Mr. Betts, testified that he would attempt to establish, either through jury

22 ⁶ Although St. Paul referred to the “owned property” exclusion in its opposition to the Meadow Valley
23 Defendants’ summary judgment motion to establish coverage under the St. Paul Fire policy, *Docket No.*
108, pp. 21-22), St. Paul conceded at the final pre-trial conference that it was conceding this issue, since
MVLLC sold the last unit January 31, 2002, fifteen months before the policy expired. In any event, if St.
Paul intends to rely on such an exclusion, it bears the burden of proof and it has not proposed a jury
instruction that would enable the jury to allocate between damage covered and damage excluded under
the owned property exclusion.

interrogatories or through an understanding of the parties, which part of the judgment or settlement would be applied to which allegation. The settlement agreement itself specified only that it involved "all claims" of the parties. Consequently, the trial court did not err in ordering Prudential to pay the entire settlement.

Prudential Property & Cas. Ins. Co. v. Lawrence, 45 Wn. App. 111, 121, 724 P.2d 418 (1986).

C. PROPERTY DAMAGE

Both St. Paul policies define "property damage" as

- a. Physical injury to tangible property of others, including all resulting loss of use of that property; or
- b. Loss of use of tangible property of others that isn't physically damaged.

None of the terms contained in the foregoing definition are defined. Undefined terms in an insurance contract must be given their popular and ordinary meaning. Harrison Plumbing & Heating, Inc. v. New Hampshire Ins. Group, 37 Wn. App. 621, 624, 681 P.2d 875 (1984). Relying on this rule of policy interpretation, the court in Lawrence relied on dictionary definitions of several of these terms to determine that obstruction of view constituted property damage.

"Damage" means "loss due to injury: injury or harm to person, property, or reputation".⁷

"Use" means, among other things, "the act . . . of using something . . . the privilege or benefit of using something"

"Property" in a thing consists not merely in its ownership and possession, but in the unrestricted right of use, enjoyment, and disposal. Anything which destroys one or more of these elements of property to that extent destroys the property itself.

⁷ In Overton v. Consolidated Ins. Co., 145 Wn.2d 417, 428, 38 P.3d 322 (2002), the court defined "damage" as "the actual loss, injury, or deterioration of the property itself."

1 Id., 45 Wn. App. at 118-19. The same dictionary defines “injury” as:

2 “Injury,” “hurt,” “damage,” “harm,” and “mischief” are synonyms that mean
3 in common the act or result of inflicting on a person or thing something that
4 causes loss, pain, distress, or impairment.

5 Webster’s Third New International Dictionary, Unabridged (Merriam-Webster 2002).

6 In this case, both parties’ building envelope experts have used definitions of
7 property damage they have developed for purposes of their work that are substantially
8 less broad. The court should preclude any of the parties’ experts from rendering
9 opinions about the meaning of “property damage” in the policies, McDonald v. State
10 Farm Fire & Cas. Co., 119 Wn.2d 724, 730, 837 P.2d 1000 (1992) (interpretation of the
11 terms of an insurance policy is a question of law for the court), and should give a
12 cautionary instruction regarding property damage as used in St. Paul’s policies at the
13 time the first expert testifies, rather than the waiting to the end of the evidence..

14 **D. BAD FAITH**

15 Both parties have proposed essentially the same pattern jury instructions
16 describing the elements and burden of proof on bad faith. It is therefore unnecessary to
17 devote discussion to the issue in this trial brief. Where the parties differ, and where the
18 court has itself expressed some uncertainty, concerns the meaning and effect of case
19 law describing (1) the remedy of coverage by estoppel, (2) the rebuttable presumption of
20 harm, and (3) covenant judgments.

21 Simply put, if the Meadow Valley Defendants prove one or more acts of bad faith
22 proximately caused them any prejudice or harm, St. Paul is estopped to deny coverage
23 or to prove any limitations or exclusions to coverage, and the covenant judgment amount

1 becomes the presumptive measure of the Meadow Valley Defendants' damage, which
 2 presumption can only be rebutted by a showing that the settlement was entered into
 3 through fraud or collusion. St. Paul is foreclosed from rebutting the presumption
 4 because the trial court in the underlying action made an express finding there was no
 5 fraud or collusion. Because St. Paul intervened and participated in the reasonableness
 6 determination, it is bound by that finding under collateral estoppel.

7 **1. Coverage by estoppel.**

8 The coverage by estoppel remedy not only relieves the insured from proving that
 9 the specific loss is in fact covered under the insuring agreement, it also deprives the
 10 insurer of any policy defenses or exclusions that might otherwise apply. "We feel it is
 11 appropriate to estop the insurer from arguing a coverage defense when the insurer
 12 breached the contract in bad faith." Kirk v. Mt. Airy Ins. Co., 134 Wn.2d 558, 564, 951
 13 P.2d 1124 (1998).

14 Safeco v. Butler, 118 Wn.2d 383, 823 P.2d 499 (1992) illustrates these principles.
 15 In Butler, there was no coverage under Butler's homeowners' insurance policy with
 16 Safeco because the acts giving rise to the insured's liability did not arise from an
 17 "accident" as required by the insuring language of the policy. Additionally, the policy
 18 contained an exclusion for intentional acts of the insured. However, the court held that if
 19 the jury found bad faith, Safeco was estopped from denying coverage." Id. at 392.

20 Butler addresses the distinction between the remedy of estoppel under a breach
 21 of contract claim, and under a tort claim for bad faith. Safeco argued that bad faith was
 22 irrelevant because "estoppel cannot be used to expand the scope of insurance contracts.
 23 . . . if Hap Butler's act is not covered, then nothing Safeco did could create coverage

1 where it did not exist.” Id. at 392. The court rejected Safeco’s reliance on an exclusively
 2 contract based analysis.

3 First, a Tank [v. State Farm], 105 Wn.2d 381, 715 P.2d 1133 (1986)]
 4 violation results in a cause of action which arises from the contract and the
 5 fiduciary relationship, which sounds in tort. Any remedy must take into
 6 account all of the aspects of the insurer/insured relationship. We cannot
 7 focus solely on the contract aspect of that relationship.

8 Second, the remedy must take into account the purpose of creating a bad
 9 faith cause of action. If the only remedy available were the limits of the
 10 contract, then there would be no distinction between an action for an
 11 insurer’s wrongful but good faith conduct, and an action for its bad faith
 12 conduct. An insurer could act in bad faith without risking any additional
 13 loss. This would render Tank meaningless. An estoppel remedy, however,
 14 gives the insurer a strong disincentive to act in bad faith. Therefore, an
 15 estoppel remedy better protects the insured against the insurer’s bad faith
 16 conduct.

17 Id. at 393-94.

18 **2. Rebuttable presumption of harm.**

19 Butler describes a claim for bad faith as sounding in tort, and recognizes that an
 20 essential element of any tort claim is that the alleged wrongful act caused harm. Id. at
 21 389. However, the court then recognized a rebuttable presumption of harm. It did so
 22 because:

23 The insured should not have the almost impossible burden of proving that
 he or she is demonstrably worse off because of the insurer’s actions.
 Imposing a rebuttable presumption of prejudice relieves the insured of that
 almost impossible burden. This reflects the fiduciary aspects of the
 insured/insurer relationship.

Id. at 390. And in Transamerica Ins. Group v. Chubb & Son, Inc., 16 Wn. App. 247, 554
 P.2d 1080 (1976), *review denied*, 88 Wn.2d 1015 (1977), the court held that an insured
 established prejudice as a matter of law where the insurer controlled the defense for ten
 months before issuing a reservation of rights. The court noted:

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1 The course cannot be rerun, no amount of evidence will prove what might
2 have occurred if a different route had been taken. By its own actions, [the
insurer] irrevocably fixed the course of events concerning the law suit for
the first 10 months. Of necessity, this establishes prejudice.

3 Id. at 252.

4 Finally, imposing a presumption of prejudice only after the insured shows
5 bad faith adequately protects the competing societal interests involved. It
6 provides a meaningful disincentive to insurers' bad faith conduct while
protecting insurers from frivolous claims.

7 Safeco v. Butler, 118 Wn.2d at 392.

8 Finally, although Butler implied that the insurer could rebut the presumption of
9 harm through any evidence establishing that the insured did not suffer actual harm, the
10 Washington Supreme Court has subsequently clarified the standard required for the
11 insurer to rebut the presumption. In Besel v. Viking Ins. Co. of Wis., 146 Wn.2d 730,
12 738-39, 49 P.3d 887 (2002), the court reviewed proceedings in the trial court approving a
13 covenant judgment settlement as reasonable.

14 Once the court determined the covenant judgment was reasonable, the
15 burden shifted to Viking to show the settlement was the product of fraud or
collusion. Having failed to meet this burden, Viking was liable for the full
settlement amount.

16 Id. at 739. And, in Truck Insurance Exchange v. Vanport Homes, Inc., 147 Wn.2d 751,
17 755, 58 P.3d 276 (2002) the court declared more universally:

18 We hold that were an insurer acts in bad faith in refusing to defend, the
19 settlements entered into by insureds with third parties and approved by a
20 court as reasonable will be presumed to be reasonable; such presumption
21 may be overcome by the insurer upon a showing that the settlements were
22 a product of fraud or collusion.
23

1 **3. Covenant judgments.**

2 In Besel, the court reviewed the development of jurisprudence discussing but
 3 often not applying (because appeals often arise from trial court dismissals or certified
 4 questions of federal courts rather than judgments on the merits) the principles underlying
 5 the coverage by estoppel and rebuttable presumption of harm remedies. The court
 6 observed that the coverage by estoppel remedy applies equally to a verdict against the
 7 insured as it does to a settlement the insured is forced to enter into as a result of bad
 8 faith conduct by an insurer. Id. at 735-36. The court also noted prior case law
 9 recognizing that an agreement not to execute the judgment against the insured does not
 10 preclude a showing of harm. Id. at 736. The court confirmed that the principles first
 11 announced in Butler do not depend on how an insurer acted in bad faith, whether by
 12 poorly defending a claim under a reservation of rights, refusing to defend a claim, or
 13 failing to properly investigate a claim. Id. at 737. The court next expressly approved the
 14 factors to be considered in evaluating the reasonableness of settlements announced in
 15 Glover v. Tacoma Gen. Hosp., 98 Wn.2d 708, 717, 658 P.2d 1230 (1983) applicable to
 16 settlements between joint tortfeasors and subsequently recognized by the Court of
 17 Appeals in Chaussee v. Maryland Casualty Co., 60 Wn. App. 504, 512, 803 P.2d 1339
 18 (1991) as equally applicable to covenant judgments between claimants and insureds.
 19 Upon conclusion of this survey of the law, the court announced:

20 We hold the amount of a covenant judgment is the presumptive measure of
 21 an insured's harm caused by an insurer's tortious bad faith if the covenant
 22 judgment is reasonable under the Chaussee criteria. This approach
 23 promotes reasonable settlements and discourages fraud and collusion. . . .
 Finally, the Chaussee criteria protect insurers from excessive judgments
 especially, where as here, the insurer has notice of the reasonableness

1 hearing and an opportunity to argue against the settlement's
2 reasonableness.

3 Id. at 738-39.

4 This outcome is not draconian when considered in relation to the burden of proof
5 and measure of damage for breach of the insurance contract. Under a breach of
6 contract claim, although an insured is required to prove that the loss falls within the
7 insuring agreement of the policy, McDonald, it is not part of the insured's burden to prove
8 actual liability under the settlement, or that 100% of the settlement amount represents
9 damages covered under the policy. PUD No. 1. In a breach of contract case, although
10 the insurer is entitled to prove that a portion of the insured's liability is subject to a
11 limitation or exclusion under the policy, E-Z Loader, if there is no basis for allocation, the
12 insured is entitled to reimbursement for both covered and non-covered aspects of the
13 claim. PUD No. 1.

14 In this case, the covenant judgment has already been determined to be
15 reasonable. Thus, the burden shifts to St. Paul to demonstrate that the covenant
16 judgment was the product of fraud or collusion. Besel, 146 Wn.2d at 739. St. Paul is
17 foreclosed from re-litigating this issue because St. Paul intervened and participated in
18 the reasonableness determination in the underlying action, where the trial judge made a
19 specific finding that there was no fraud or collusion. St. Paul Fire is thus collaterally
20 estopped from arguing fraud or collusion because it has already had the opportunity to
21 fully and fairly argue this issue. See, Christiansen v. Grant County Hosp. Dist. No. 1,
22 152 Wn.2d 299, 307, 96 P.3d 957 (2004).
23

1 Therefore, under well-settled Washington law, the underlying covenant judgment
2 is the presumptive measure of the Meadow Valley Defendants' harm. Consequently, if
3 the jury finds bad faith, then the court should enter damages in the amount of \$4.8
4 million, the amount of the covenant judgment, and the quantum of damages should not
5 be submitted to the jury.

6 DATED this 14th day of September, 2006.

7 STAFFORD FREY COOPER

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CERTIFICATE OF SERVICE

I hereby certify that I electronically filed a copy of this document entitled
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